



THE UNIVERSITY
of NORTH CAROLINA
at CHAPEL HILL

INTERNAL AUDIT
DEPARTMENT

HILL COMMERCIAL BUILDING
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May 19, 2017

Dr. Carol Folt, Chancellor
103 South Building
Campus Box 9100

Dear Dr. Folt:

I have enclosed the report from our recently completed special review of the Development Finance Initiative in the School of Government. Please call me at (919) 962-7883 if you have any questions about the review or report.

Sincerely,

A handwritten signature in cursive script that reads "Phyllis C. Petree".

Phyllis C. Petree
Chief Audit Officer

Attachment

**The University of North Carolina at Chapel Hill
Internal Audit Department
Special Review – Development Finance Initiative
May 19, 2017**



THE UNIVERSITY
of NORTH CAROLINA
at CHAPEL HILL

Distribution of Final Report

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May 19, 2017

Dr. Carol L. Folt, Chancellor
103 South Building
Campus Box 9100

Dear Dr. Folt:

We have completed a review of the Development Finance Initiative (DFI) in the School of Government (School). We initiated this review after receiving a report of allegations of possible improper procurement of services and potential conflicts of interest with a vendor used by DFI -

Our procedures included an examination of all payments to as well as proposals for services submitted and contracts between the University and . We also searched the Secretary of State's Corporations database for information about outside businesses related to DFI staff members and Connect Carolina to determine if any payments had been made to staff member's businesses. We discussed with School management the origins of engaging and how external professional activities for pay and potential conflict of interest and commitment are managed.

We found no evidence that DFI funds had been misused. However, based on the procedures we performed, we conclude that the financial connection between the and the owner of was not properly disclosed. These two individuals have current and prior business relationships. of DFI's contracts with were sole source procurements.

We also found that the has primary financial control over use of funds, a situation that creates a conflict of interest between the and .

In addition, we found that the has multiple outside business interests that have not been disclosed for review as potential conflicts of interest or conflicts of commitment or as possible external activities for pay that required approval.

Details of these issues and recommendations to address them are in the Findings and Recommendations section of this report.

We believe that no additional work is necessary at this point but will follow-up on the results of the new procedures during the next University-wide follow-up. If you have any questions about our review, please call me at 962-7883.

Sincerely,

Phyllis C. Petree
Chief Audit Officer

Findings and Recommendations

Vendor Relationship

The financial relationship between the owner of _____ – a private entity - and _____ of the Development Finance Initiative at the School of Government (_____, DFI, and School) needs to be fully disclosed and reviewed as a potential conflict of interest as does the financial involvement in _____.

On March 26, 2014, _____ submitted a proposal to provide _____ services to DFI. These services would relate to DFI projects that assist local governments in North Carolina with downtown and community redevelopment, building reuse, and master planning.

March 2014 proposal was signed by the _____ in his separate capacity as the _____. The proposal was sent to the School's Business and Finance Office for processing with a waiver of competition form and justification (sole source) attached to the proposal. This packet of information did not disclose that the _____ was also a School employee and that he _____ of the School that would be using _____ services.

The School's former Dean for Administration questioned the propriety of paying a business owned by a School employee to provide services to the School.

On April 16, 2014, _____ resubmitted its proposal. The April proposal named a different individual as the _____ of _____. This individual is a current and former business associate of the _____. The association was not disclosed and the contract for services was awarded via a sole source procurement.

Sole source procurements were used to award contracts to _____ in fiscal years 2015, 2016, and 2017. The potential conflicts of interest due to the business association between the owner of _____ and the _____ were not disclosed as part of these procurements.

Based on our review of email correspondence, DFI annual reports, and expenditure documents, we conclude that the University received appropriate value for the payments made to _____.

However, the business associations between the owner of _____ and the _____ and the financial involvement in _____ create a conflict of interest that must be addressed.

See finding titled Financial Role in _____ for additional conflict of interest concerns.

Recommendation

We recommend that complete information about _____ – the history of its creation, complete information about its ownership, who has financial control over the entity, etc. - be immediately reported to the Conflict of Interest Officer for review.

This review will determine if contracts between the University and _____ can continue and, if so, what processes must be in place to management the potential conflict of interest.

This review should also assess what conflict of interest disclosures the _____ should make in connection with his financial role in _____.

Management's Response:

The School of Government agrees with the finding.

The was established by the as a tool to help deliver the work of DFI. As has been stated by the UNC chief audit officer, no evidence of misuse of funds was uncovered in this special audit and the University received appropriate value for payments to . Involved School employees are honest, loyal, and passionate about the mission of DFI and the School of Government. All contracts between the University and were approved through UNC processes.

Effective March 1, 2017, following consultations with the UNC conflict of interest officer, the

On March 1, 2017, the School's senior associate dean, a faculty member who works closely with DFI, and the met with the UNC conflict of interest officer to discuss potential conflicts and their reporting and management. Reporting and management are ongoing.

The School extended, with approval from UNC associate university counsel and after conferring with the UNC chief audit officer, its agreement with through May 31, 2017. The extension permits the completion of important contractual DFI work that requires the support of contractors.

The University does not anticipate entering into another agreement with after May 31, 2017.

School senior managers are in ongoing conversations with UNC associate university counsel, UNC chief auditor, and UNC conflict of interest officer about ways to support future DFI work within UNC policy.

The School's senior associate dean is responsible for correcting the reported issues with assistance from the

Financial Role in

The has financial control over funds belonging to . He approves and makes payments from the funds and uses a debit card tied to the bank account for miscellaneous expenses such as office expenses, internet services, cell phone services, and his travel, and business entertainment.

Our review of payments the University made to showed most of the checks payable to were endorsed by the individual who is the . He endorsed these checks as part of his financial authority for (payments are now made by electronic funds transfer). We were able to trace all payments to to a bank account in the name of

A University employee should not have this degree of financial control of an outside entity that provides services to the unit where he works.

Further, the [redacted] should not use [redacted] funds to pay for his University-related travel and business entertainment expenses. These costs should be reimbursed from University funds and subject to the limits and approvals set by University policy.

Recommendation:

The COI/COC management plan related to DFI and [redacted] should include recommendations for reducing the risks created by the [redacted] financial role in [redacted]. It may be necessary for the [redacted] to relinquish his financial role in [redacted].

The [redacted] should not charge his DFI-related travel and business entertainment expenses to funds. Requests for reimbursement of these types of expenses should be submitted for review, approval, and payment through University processes and systems.

Management's Response:

The School of Government agrees with the finding.

As noted in a previous section, effective March 1, 2017, as a result of consultation with the UNC conflict of interest officer, the [redacted]

[redacted]. The School's senior associate dean is making those decisions.

From March 1, 2017 forward, the [redacted] has been required to seek reimbursement of DFI-related travel expenses from the School, rather than from [redacted].

The School's senior associate dean is responsible for correcting the reported issue.

Outside Businesses and External Professional Activities for Pay

The [redacted] has been associated with multiple external businesses since he was appointed to his position at the School. Most of these businesses were engaged in real estate, real estate development, or community and economic development work, activities related to his University duties.

One of these businesses - [redacted] - has been disclosed as a potential conflict of interest or commitment. As a condition of employment, the [redacted] was required to step down as [redacted] of [redacted] because of the potential for conflict of interest with his work for the University.

However, we find no evidence that he disclosed any of his 38 other outside businesses that existed at the time of his DFI appointment or the 9 businesses that have been created since then. Forty-one of these businesses were engaged in real estate or community development. Twenty-three of the businesses are still active per the Secretary of State's website.

We also noted that the [redacted] has disclosed only one of his outside businesses, one related to his role as [redacted] of the [redacted], as an external professional activity for pay.

None of these businesses have received payments from the University.

Recommendation:

Each of these outside businesses should be reported as possible external activities for pay or potential conflicts of interest/commitment. The Conflict of Interest Office and School management should develop processes to ensure that these activities are managed in keeping with UNC System policies.

Management's Response:

The School of Government agrees with the finding.

As noted in the previous section, on March 1, 2017, the School's senior associate dean and employees affected by this audit met with the UNC conflict of interest officer to discuss potential conflicts and their reporting. Consulting with university officials, reporting, and creating a way to manage potential conflicts of interest/ commitment are ongoing.

The School will notify annually all covered School employees of their responsibilities to report external professional activity for pay. We expect to do this during the annual review process at the end of each fiscal year.

The _____ is responsible for disclosure of external professional activity for pay. The School's senior associate dean is responsible for correcting the reported issues.

Payment Practices

We found that DFI typically pays _____ in advance for its services. For example:

<u>Services Period</u>	<u>Date Paid</u>
December 2016	11/28/16
January 2017	01/06/17
February 2017	02/09/17

Finance Policy 703 – Advance Payments for Vendors requires that goods be received or services complete before payment will be made to a vendor, except for certain types of exclusions.

Recommendation:

We recommend that DFI end the practice of paying _____ invoices before work for the period billed is complete.

Management's Response:

The School of Government agrees with the finding.

On February 28, 2017, School senior managers met with UNC associate general counsel and the UNC chief auditor. In that meeting, it was agreed that the School could extend for _____ months, through _____ its existing agreement with _____ to support the work of DFI unchanged.

The School accepts the risks associated with this practice for the short time left in the agreement with

was established as a tool to support DFI, an activity of the School. It has never had excess cash, and payment in advance of completion of work is necessary to pay expenses. As noted above, the has on several occasions made loans from personal interests to allow to pay its expenses.

Going forward, the School will seek to avoid contracts that provide for payment before completion of work.

The School's associate dean for administration is responsible for correcting the reported issue.

Travel Payments and Reimbursements to Project Managers

We found that DFI paid additional amounts (approximately \$10,700) for travel expenses in fiscal year 2015. contract for fiscal year 2015 stated that its

The additional payments for travel costs should not have been made and need to be recovered.

Also, in fiscal years 2016 and 2017, DFI reimbursed three project managers engaged by for out-of-pocket costs for supplies, meals, business entertainment, and travel. In our opinion, these costs were the responsibility of and should not have been paid by the University. Further, project managers receive a monthly travel stipend instead of having their travel costs reimbursed.

Recommendation:

The School needs to recover the extra \$10,700 in travel costs paid to in fiscal year 2015. The amounts that the University paid to project managers as reimbursement for travel costs and other out-of-pocket in fiscal years 2016 and 2017, approximately \$4,200 need to be recovered.

We recommend that DFI end the practice of reimbursing project managers.

Management's Response:

The School of Government agrees with the finding.

As we discussed in a March 27, 2017 meeting with the UNC chief auditor, the orally modified agreements with project managers to say that would reimburse them for travel that was not directly associated with projects for which they were directly responsible. In that oral modification, the described travel stipend was meant to support travel in support of projects for which project managers had direct responsibility, but not other travel that benefited DFI (for example, to attend a town council meeting to see a presentation and questions about another manager's project). In addition, the modified the agreement with one project manager to provide reimbursement for travel to and from NC required by that project manager's change in residence to another state.

Because the modified the agreements, we believe these are legitimate. expenses in support of DFI related work and were thus legitimately billed to the School. We recognize orally modifying a written agreement with a vendor is an inappropriate practice. We have stopped this

practice and in the future will only seek to reimburse employees or contractors for travel with University funds in accordance to University policy. The University will be made whole for the \$14,900 in identified travel.

The School's associate dean for administration is responsible for correcting the reported issue.

Individuals Providing Responses: Tom Thornburg, Senior Associate Dean of the School of Government, provided management's responses to the findings and recommendations in this report. Appropriate members of University management have reviewed the complete report.